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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 243

F. E. GOODING AND ELIZABETH GOODING, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. App. A. 1a-14a, 18a-19a) is reported at 326 F. 2d 988.

JURISDICTION

The decision of the Court of Claims was entered on January 24, 1964, and the government's motion for reconsideration of the decision was denied on April 3, 1964 (Pet. App. A. 1a, 18a-19a). The taxpayers' petition for a writ of certiorari was filed on July 2, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. Whether the mitigation provisions of the Internal Revenue Code of 1954 (Sections 1311-1314), allowing the correction of an income tax error in a year otherwise barred by the statute of limitations, apply only to the particular items which were the subject of a prior determination (in this case by a prior Tax Court decision).

2. Whether the taxpayers are entitled to a refund of a tax payment erroneously made by them under the doctrine of equitable recoupment when the mitigation provisions of the 1954 Code apply and limit the extent of the recovery.

STATUTES AND REGULATIONS INVOLVED

The relevant portions of Sections 1311, 1312, 1313, and 1314 of the Internal Revenue Code of 1954, and Section 1.1312-7(c), Treasury Regulations on Income Tax (1954 Code), are set forth in the Appendix, *infra*, pp. 8-12.

STATEMENT

On August 24, 1946, the taxpayers and their minor daughter transferred to a newly-organized corporation, Gooding Amusement Company, Inc., their respective interests in the assets of an amusement-park equipment business. In return, the taxpayers and their daughter received all of the corporate common stock, certain notes of the corporation, and an assumption by the corporation of their liability for the debts of the business. Mr. Gooding received five notes totalling $81,572.08, and Mrs. Gooding received five notes totalling $66,286.04 (Pet. App. A. 2a, 14a-16a).

For the year 1946, the taxpayers filed separate income tax returns treating the exchange as giving rise to taxable gains because the notes received in the transaction were "other property" or "boot" under Section 112(c) of the Internal Revenue Code of 1939. Mr. Gooding recognized long-term capital gains of $65,561.76 and Mrs. Gooding recognized long-term capital gains of $32,780.87 (*i.e.*, the consideration received by each, less the adjusted basis of the assets attributable to each). A capital gains tax was paid on these sums (Pet. App. A. 2a, 14a-16a).

In 1947 the corporation paid the first of the notes held by Mr. Gooding ($26,514.42) and part of one of the notes held by Mrs. Gooding ($5,000). In 1948 another of the notes held by Mr. Gooding in the amount of $26,514.42 was paid. After the time for a refund for 1946 had run, the Commissioner of Internal Revenue determined that the payments on these notes in 1947 and 1948 represented distributions of earnings and profits, fully taxable at ordinary income rates as a dividend. The Commissioner was sustained by the Tax Court (*Gooding Amusement Co. v. Commissioner*, 23 T.C. 408, affirmed, 236 F. 2d 159 (C.A. 6), certiorari denied, 352 U.S. 1031) in a decision which became final on March 11, 1957 (Pet. App. A. 3a).

A few months later taxpayers filed claims for refund of the capital gains taxes paid for 1946, which claims were rejected on June 16, 1958. In 1959 taxpayers brought suit in the Court of Claims. The court held that Sections 1311-1314 apply to mitigate the bar of limitations as claimed by the taxpayers but limited their recovery to that portion of the capital

gains allocable to the three notes paid in 1947 and 1948 which were the subject of the Tax Court's decision (Pet. App. A, 3a-14a, 16a-19a).

ARGUMENT

1. Sections 1311-1314 of the Internal Revenue Code of 1954, Appendix, *infra*, pp. 8-10, provide that where an error has been made in the inclusion or exclusion of income, or in the allowance or disallowance of a deduction, or in the tax treatment of a transaction affecting the basis of property, the error may be corrected even though the ordinary period of limitations has run. However, not all such errors may be corrected. These provisions apply to allow correction of the error in the barred year only when a "determination" is made, by the Tax Court or another specified agency, in a subsequent year treating the item inconsistently with the way it was treated by the taxpayer in the barred year. Sections 1311, 1313. The Court of Claims found that the Tax Court's earlier holding that the payments in 1947 and 1948 were fully taxable at ordinary income rates had determined the basis of property inconsistently with the taxpayers' treatment of it in their 1946 return and therefore satisfied Sections 1311 and 1312. It concluded that the mitigation provisions removed the bar of limitations as to the capital gain on the notes which were paid in 1947 and 1948.

However, the Court of Claims held that the mitigation provisions did not apply to the capital gain on the notes which were not paid in 1947 and 1948. Sections 1311 and 1312 apply only on the basis of a "determination" that there has been a prior error. Further-

more. Section 1314(a), which limits the amount of the adjustment under the mitigation provisions, provides that the adjustment is confined to that 'which results solely from the correct treatment of the item which was the subject of the error * * *." And the legislative history of these provisions specifically states that they are "predicated on the principle that correction is made only with respect to the item involved in the determination. The operation of the bar of the statute of limitations is not affected with respect to any other item, even though such other item also has been erroneously treated in the same year. As to these items there has been no change of position, no double tax or double deduction, to call for the relief provided by this section." S. Rep. No. 1567, 75th Cong., 3d Sess. 52.

The prior Tax Court determination on which this case rests held that the 1947 and 1948 payments on three notes represented dividend distributions to the taxpayers, not returns of capital. Thus, the Tax Court determined only that the taxpayers erred in the reporting of gain or receipt of these three notes in 1946. While the Tax Court decision means as a matter of *stare decisis* that the other notes were treated erroneously in 1946, that issue was not actually even before it. Since the Tax Court determination was limited to the three notes which were paid, the mitigation provisions do not apply to the other notes. This conclusion of the Court of Claims was consistent with that of each court of appeals which has considered the issue. See *Central Hanover Bank & Trust Co.* v.

United States, 163 F. 2d 60, 64 (C.A. 2); *Estate of Gill* v. *Commissioner*, 306 F. 2d 902, 906 (C.A. 5); *First Nat. Bank of Phila.* v. *Commissioner*, 205 F. 2d 82, 86 (C.A. 3).

2. The taxpayers' contention that they are entitled to refund under the equitable remedy of recoupment is also without merit. As the Court of Claims said (Pet. App. A, 13a-14a):

> When Congress established the detailed provisions of the mitigation sections it intended, we think, that they supersede any common-law recoupment remedies with respect to the categories designated in section 1312. Since plaintiffs are covered by Section 1312(7), they must also accept the bounds of the relief Congress has granted.

Taxpayers can cite no cases which are in conflict, and the commentators considering the point are in agreement with the court's holding. See Maguire, Surrey and Traynor, *Section 820 of the Revenue Act of 1938*, 48 Yale L.J. 509, 719, 773-775 (1939); Note, *Sections 1311-15 of the Internal Revenue Code: Some Problems in Administration*, 72 Harv. L. Rev. 1536, 1537, note 8 (1959).

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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JULY, 1964.

APPENDIX

Internal Revenue Code of 1954:

SEC. 1311. CORRECTION OF ERROR.

(a) *General Rule.*—If a determination (as defined in section 1313) is described in one or more of the paragraphs of section 1312 and, on the date of the determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law or rule of law, other than this part and other than section 7122 (relating to compromises), then the effect of the error shall be corrected by an adjustment made in the amount and in the manner specified in section 1314.

(b) *Conditions Necessary for Adjustment.*—

(1) *Maintenance of an inconsistent position.*—Except in cases described in paragraphs (3)(B) and (4) of section 1312, an adjustment shall be made under this part only if—

(A) in case the amount of the adjustment would be credited or refunded in the same manner as an overpayment under section 1314, there is adopted in the determination a position maintained by the Secretary or his delegate * * *.

* * * * *

and the position maintained by the Secretary or his delegate in the case described in subparagraph (A) * * * is inconsistent with the erroneous * * * recognition * * *.

* * * * *

SEC. 1312. CIRCUMSTANCES OF ADJUSTMENT.

The circumstances under which the adjustment provided in section 1311 is authorized are as follows:

* * * * * *

(7) [as amended by Sec. 59(a), Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606, 1647] *Basis of property after erroneous treatment of a prior transaction.*—

(A) *General rule.*—The determination determines the basis of property, and in respect of any transaction on which such basis depends, or in respect of any transaction which was erroneously treated as affecting such basis, there occurred, with respect to a taxpayer described in subparagraph (B) of this paragraph, any of the errors described in subparagraph (C) of this paragraph.

* * * *

(C) *Prior erroneous treatment.*—With respect to a taxpayer described in subparagraph (B) of this paragraph—

* * * * *

(ii) there was an erroneous recognition, or nonrecognition, of gain or loss * * *

* * * * *

SEC. 1313. DEFINITIONS.

(a) *Determination.*—For purposes of this part, the term "determination" means—

(1) a decision by the Tax Court or a judgment decree, or other order by any court of competent jurisdiction, which has become final;

* * * * *

SEC. 1314. AMOUNT AND METHOD OF ADJUSTMENT.

(a) *Ascertainment of Amount of Adjustment.*—In computing the amount of an adjustment under this part there shall first be ascertained the tax previously determined for the taxable year with respect to which the error was made. * * *

* * * * *

There shall then be ascertained the increase or decrease in tax previously determined which results solely from the correct treatment of the item which was the subject of the error (with due regard given to the effect of the item in the computation of gross income, taxable income, and other matters under this subtitle).

* * * * *

( ) *Adjustment Unaffected by Other Items.*—The amount to be assessed and collected in the same manner as a deficiency, or to be refunded or credited in the same manner as an overpayment, under this part, shall not be diminished by any credit or set-off based upon any item other than the one which was the subject of the adjustment. * * *

* * * * *

Treasury Regulations on Income Tax (1954 Code):

§ 1.1312-7 [as amended by T.D. 6617, 1962-2 Cum. Bull. 196] *Basis of property after erroneous treatment of a prior transaction.*

* * * * *

(c) The application of this section may be illustrated by the following examples:

* * * * *

Example (5). In 1946 a taxpayer received 100 shares of stock of the X Corporation having a fair market value of $5,000, in exchange for shares of stock in the Y Corporation which he had acquired at a cost of $12,000. In his return for 1946 the taxpayer treated the exchanges as one in which gain or loss was not recognizable. The taxpayer sold 50 shares of the X Corporation stock in 1947 and in his return for that year treated such shares as having a $6,000 basis. In 1952, the taxpayer sold the remaining 50 shares of stock of the X Corporation for $7,500 and reported $1,500 gain in his return for 1952. After the expiration of the period of limitations on deficiency assessments and on refund claims for 1946 and 1947, the Commissioner asserted a deficiency for 1952 on the ground that the loss realized on the exchange in 1946 was erroneously treated as nonrecognizable, and the basis for computing gain upon the sale in 1952 was $2,500, resulting in a gain of $5,000. The deficiency is sustained by the Tax Court in 1955. And adjustment is authorized with respect to the year 1946 as to the entire $7,000 loss realized on the exchange, as the Court's decision determines the basis of property, and in a prior transaction upon which such basis depends there was an erroneous nonrecognition of loss to the

taxpayer with respect to whom the determination was made. No adjustment is authorized with respect to the year 1947 as the basis for computing gain upon the sale of the 50 shares in 1952 does not depend upon the transaction in 1947 but upon the transaction in 1946.

[26 C.F.R. 1.1312-7.]

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